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No. 1100 66

In the Supreme Court of the United States

OCTOBER TERM, 1941

EMIL H. STRASSBURGER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 12–17) is not officially reported. The opinions of the Circuit Court of Appeals (R. 32–35) are reported in 124 F. (2d) 315.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 7, 1942. (R. 36.) The petition for a writ of certiorari was filed on April

3, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the sole owner of all the issued voting common stock of a corporation realized taxable income upon the receipt of a stock dividend paid in seven percent non-voting cumulative preferred stock which was declared out of earnings and profits.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra*, pp. 7–11.

STATEMENT

The facts, as stipulated (R. 25–27) and as found by the Board of Tax Appeals (R. 12–14), may be summarized as follows:

E. H. Strassburger, Inc., sometimes hereinafter referred to as the Corporation, was organized in or about January, 1932. On December 10, 1936, its authorized capital stock consisted of 200 shares of common stock with exclusive voting rights. (R. 12–13.) The petitioner owned all of this stock (R. 13).

On December 11, 1936, the Corporation's articles of incorporation were amended for the creation and authorization of an issue of 500 shares of $100 par value seven percent cumulative non-voting preferred stock (R. 13). On December 21, 1936,

the board of directors of the Corporation adopted a resolution of which the following is material (R. 13):

> *Now, therefore, be it resolved,* that for the purpose of representing in the capitalization of this corporation surplus assets to the extent of Five Thousand Dollars, a distribution among stockholders of the capital stock of the corporation be made of Five Thousand Dollars of preferred capital stock, and the proper officers of the corporation are hereby authorized and directed to issue an aggregate of Five Thousand Dollars, par value of preferred capital stock of this corporation, in payment of a stock dividend on the common stock of this corporation.
>
> *Further resolved,* that the directors of this corporation be authorized to distribute said Five Thousand Dollars of the preferred capital stock, pro rata, among stockholders, as and for a stock dividend on said capital stock so owned by them, such distribution to be made to stockholders of record at the close of business on December 24, 1936.

On December 24, 1936, pursuant to this resolution, 50 shares of preferred stock of the Corporation were issued to petitioner, the sole common stockholder. At the time of the distribution of the stock dividend the Corporation had earnings and profits accumulated subsequent to February 28, 1913, in excess of $5,000. Appropriate book entries were made on account of the dividend, decreasing the surplus of the Corporation by $5,000 and in-

creasing its capital stock in the same amount. (R. 13–14.)

On December 29, 1936, the 50 shares of preferred stock which petitioner had received as a dividend were transferred to his wife, Gertrude W. Strassburger. Upon her death the shares were retransferred to petitioner who is now the record holder. No dividends have been paid on the preferred stock and that stock has never been disposed of, canceled or retired. (R. 14.)

The Board of Tax Appeals held that the stock dividend represented a new and different interest in the corporation and therefore constituted taxable income (R. 14–17). The court below, with Judge Chase dissenting, affirmed the decision of the Board of Tax Appeals (R. 32–35).

ARGUMENT

We oppose the granting of the petition. It is true that the Government desires a reexamination of *Eisner* v. *Macomber*, 252 U. S. 189, but this case is an inappropriate one for that purpose, since it was correctly decided on any theory. The dividend here was not in the form of common upon common, as was the situation in *Eisner* v. *Macomber*. Here, corporate earnings were set aside and cumulative non-voting preferred stock was issued against those earnings to petitioner, who, prior thereto, owned only common stock. Those corporate earnings were thus made available to petitioner in the form of a new and different class of stock, and were

therefore taxable to him in accord with the theory underlying *Helvering* v. *Gowran*, 302 U. S. 238, and *Koshland* v. *Helvering*, 298 U. S. 441, irrespective of the correctness of *Eisner* v. *Macomber*.

The Government did seek a reexamination of *Eisner* v. *Macomber* in *Helvering* v. *Sprouse*, No. 894, present Term, certiorari denied, March 2, 1942, rehearing denied, March 30, 1942. The *Sprouse* case involved a dividend of non-voting common upon common, and it may be that the issue was not squarely raised in that case for that reason. The instant case presents a situation that is even more remote from *Eisner* v. *Macomber*, since the dividend stock here was of an entirely different class from the parent stock. Moreover, even upon the narrower ground, the Government in the *Sprouse* case alleged a conflict with the decision in the instant case (Pet. 10–11), and the denial of certiorari in the *Sprouse* case would seem to remove any basis for certiorari here upon that narrower ground.

Petitioner alleges further conflicts with two other decisions, *Clark* v. *Commissioner*, 77 F. (2d) 89 (C. C. A. 3d), and *Commissioner* v. *Brown*, 69 F. (2d) 602 (C. C. A. 7th). Neither of those cases presented the issue involved herein. The *Clark* case involved an exchange of stock for other stock, rather than a stock dividend. The *Brown* case turned upon whether the redemption of certain stock was the equivalent of a distribution of a taxable dividend under Section 201 (g) of the Revenue Act of 1926. In any event, the Revenue Acts then

in force, unlike the Revenue Act of 1936, exempted all stock dividends from tax.

CONCLUSION

The petition should be denied.

Respectfully submitted.

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APRIL 1942.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from * * * dividends, * * *.

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

* * * * *

(f) *Stock Dividends.*—

(1) *General Rule.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(2) *Election of Shareholders as to Medium of Payment.*—Whenever a distribution by a corporation is, at the election of

any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (1), or (B) in money or any other property (including its stock or in rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (1)), then the distribution shall constitute a taxable dividend in the hands of all shareholders, regardless of the medium in which paid.

* * * * *

Treasury Regulations 94, relating to the Revenue Act of 1936:

ART. 115-7. *Stock dividends.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution. The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute income within the meaning of the Constitution.[1] The distinc-

[1] See *Eisner* v. *Macomber* (252 U. S. 189, T. D. 3010, C. B. 3, 25); and *Koshland* v. *Helvering* (56 Sup. Ct., 767, Ct. D. 1124, C. B. XV-1, 219). Compare *United States* v. *Phellis* (257 U. S., 156, T. D. 3270, C. B. 5, 37); *Rockefeller* v. *United States* (257 U. S., 176, T. D. 3271, C. B. 5, 34); *Cullinan* v. *Walker* (262 U. S., 134, T. D. 3508, C. B. II-2, 55); *Weiss* v. *Stearn* (265 U. S., 242, T. D. 3609, C. B. III-2, 51); and *Marr* v. *United States* (268 U. S., 536, T. D. 3755, C. B. IV-2, 116).

tion between a stock dividend which does not, and one which does, constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution is the distinction between a stock dividend which works no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and a stock dividend where there either has been a change of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the shareholder after the distribution is essentially different from his former interest. A stock dividend constitutes income if it gives the shareholder an interest different from that which his former stock holdings represented. A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old.

Example (1): The X Corporation had an authorized capital stock of $300,000 of common stock, par value $10 a share, and $100,000 of 7 percent cumulative preferred stock, par value $100 a share, which is preferred as to dividends, has no voting rights, and may be redeemed at any time at $105 per share. The articles of incorporation provide that the annual dividend on the preferred stock may be paid in cash or, at the option of the corporation, in one share of common stock for each share of preferred. On July 1, 1936, the X Corporation had outstanding $200,000 of common stock and $100,000 of preferred stock, earnings and profits of $60,000 accumulated since Febru-

ary 28, 1913, and earnings and profits of the taxable year amounting to $15,000. On July 1, 1936, it distributed 1,000 shares of its common stock of an aggregate par value (and fair market value) of $10,000 to the holders of its preferred stock in payment of the annual dividend on such stock. The stock so distributed constitutes a taxable stock dividend to the holders of the preferred stock.

Example (2): On July 1, 1936, the Y Corporation had an authorized capital stock consisting of 1,000 shares of common stock, par value $100 a share, of which 500 shares were outstanding. It had earnings and profits of $40,000 accumulated since February 28, 1913, and $5,000 of earnings and profits of the taxable year. On July 1, 1936, the Y Corporation issued and divided among its shareholders 250 additional shares of its common stock of a total par value of $25,000 and transferred an equivalent amount from surplus account to capital stock account. The stock so distributed does not constitute a taxable stock dividend to the shareholders.

Example (3): The Z Corporation had an authorized capital stock of 30,000 shares of common, without par value, and 10,000 shares of 7 percent cumulative preferred stock, par $100, which is preferred as to dividends, has voting rights and may be redeemed on the 1st of January or July of any year by the payment of $105 per share and accrued dividends. On July 1, 1936, the company's issued and outstanding stock amounted to 20,000 shares of common and 6,000 shares of preferred, and it had $250,000 earnings and profits accumulated since February 28, 1913, and $90,000 earnings and profits of the taxable year. On July 1, 1936, it paid a dividend on its common stock in preferred stock at the rate of 1/10 share of

preferred on each share of common outstanding. The preferred stock so distributed constitutes a taxable stock dividend to the holders of common stock.

T. D. 5110, 1942–4 Int. Rev. Bull. 7:

Article 115–7 of Regulations 94 [section 3.115–7, Title 26, Code of Federal Regulations] and article 115–7 of Regulations 101 [section 9.115–7, Title 26, Code of Federal Regulations, 1939 Sup.] are each amended by striking out all of the matter appearing after the first sentence thereof.

(This Treasury decision is issued under the authority contained in section 62 of the Revenue Act of 1936 (49 Stat., 1673, 26 U. S. C., Sup. 62) and section 62 of the Revenue Act of 1938 (52 Stat., 480, 26 U. S. C., Sup. 62).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved January 19, 1942.

U. S. GOVERNMENT PRINTING OFFICE: 1942